REGIONS

July 13, 2018

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve
Eccles Board Building
20th and C Street, N.W.
Washington, D.C. 20219

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

The Honorable Joseph Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, S.W.
Washington, D.C. 20219

Re: Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Loss Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Conforming Amendments to Other Regulations

Dear Chairman Powell, Chairman McWilliams, and Comptroller Otting:

Regions Financial Corporation[1] ("Regions") submits the following comments to the Agencies in response to the Notice of Proposed Rulemaking ("Proposal") regarding Regulatory Capital Rules: Implementation and Transition of the Current Expected Credit Loss Methodology for Allowances and Related Adjustments to the Regulatory Capital Rules and Conforming Amendments to Other Regulations (RIN 1557-AE32) published in the Federal Register on May 14, 2018.[2]

Regions appreciates the opportunity to comment on the Proposal from the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (collectively, the "Agencies"), and respectfully offers the comments and recommendations outlined in this letter.

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[1] Regions Financial Corporation (NYSE: RF), with $123 billion in assets, is a member of the S&P 500 Index and is one of the nation's largest full-service providers of consumer and commercial banking, wealth management, mortgage, and insurance products and services. Regions serves customers across the South, Midwest and Texas, and through its subsidiary, Regions Bank, member FDIC and an Equal Housing Lender, operates approximately 1,500 banking offices and 1,900 ATMs. Additional information about Regions and its full line of products and services can be found at www.regions.com.

[2] 83 Fed. Reg. 22312 (May 14, 2018).

In June 2016, the Financial Accounting Standards Board ("FASB") revised the accounting for credit losses under U.S. generally accepted accounting principle ("U.S. GAAP") by replacing the incurred loss methodology with the Current Expected Credit Losses methodology ("CECL"). Under CECL, a bank recognizes "expected credit losses" over the contractual life of a loan. This accounting change is one of the most impactful rule changes for financial institutions in recent history, and will have dramatic impacts on bank balance sheets, lending activities, and cost and availability of credit to customers. Regions believes the adoption of CECL will have negative impacts upon financial statement users as well as the broader economy, which include the following:

- CECL will likely result in unintended changes in the pricing, terms, and availability of many products, in particular longer-dated products, such as residential mortgage loans
- The pro-cyclical nature of CECL will create a strong disincentive for banks to continue lending in a stressed environment, which will likely heighten and extend economic downturns
- CECL does not accurately depict the economics of lending transactions and will create significant challenges for users of financial information to discern the true performance of financial institutions
- CECL will dramatically increase capital reserve requirements to unnecessarily high levels

We recognize that some of these concerns may not be within the control of the Agencies; however, we believe it is imperative that these items are appropriately evaluated for their potential long-term impacts to the overall economy. Regions recommends that the Agencies engage with the FASB to seek a delay in the implementation of CECL in order to provide adequate time to conduct a quantitative impact study on CECL's impact to consumers, investors, and the broader economy.

In addition to a delay in implementation, Regions believes certain modifications to the CECL methodology should be evaluated to ensure the needs of all stakeholders are met. The potential modifications outlined in this letter will provide financial statement users with better decision-useful information around expected credit losses.

Irrespective of any modifications to the CECL methodology, adjustments to the regulatory capital framework should be made in order to maintain capital neutrality and avoid unnecessary increases in bank capitalization levels.

Finally, additional consideration should be given to the incorporation of CECL into stress testing in order to maintain transparency and flexibility for future adjustments as needed.

Our recommendations are outlined in more detail within the remaining sections of this letter and we look forward to working with the Agencies on these important matters.

<u>A Quantitative Impact Study Should Be Performed to Understand CECL's Impact on Consumers and the U.S. Economy</u>

The new CECL methodology requires banks to recognize lifetime credit losses at the date of origination of a loan, while revenues are recognized over the life of the loan. Accordingly, any growth in lending will result in an immediate and potentially substantial negative impact to earnings and capital and will act as a strong disincentive to make credit available to customers in a stressed environment. The pro-cyclical impact that CECL has on lending will have a detrimental effect on the economy due to the reduction in credit availability. CECL will incentivize banks not to lend during a downturn because the provision costs of those loans would be punitively high given the existing economic outlook. As a result, CECL could have the impact of making economic stresses last longer, delay economic recoveries, and limit banks' ability to effectively deploy capital in order to support the economy through the cycle.

CECL will likely negatively affect credit availability and drive unintended changes to the price, availability, and structure of credit in the United States. In particular, CECL will have a negative effect on residential mortgage lending (especially in longer term products like the 30-year residential mortgage). Lending institutions will be incentivized to structure loans with shorter contractual terms, thereby creating meaningful refinance risk for consumers who have limited means to manage that risk.

Additionally, possible changes to the mortgage market, including GSE reform, normalization of the Federal Reserve's balance sheet along with the impacts of CECL on longer dated fixed assets such as mortgage assets, should be evaluated as those items together could result in higher borrowing costs for consumers. A recent proposal released by the White House for government reform and reorganization[3] outlined a plan for mortgage reform that indicated a desire to attract more layers of private capital into the mortgage market. This private capital would serve as a backstop to stand in front of the federal government's guarantee in catastrophic circumstances, thus minimizing the risk of taxpayer-funded bailouts. Whereas the government's involvement in the mortgage market has served to reduce volatility in borrowing costs in the past, private investors' required return expectations will likely fluctuate more regularly with changing market and credit conditions. This dynamic combined with the possibility that banks may require higher returns on mortgage assets or worse, reduce lending in this space, could drive mortgage rates higher for consumers. Implementing new policy of the magnitude of CECL will be disruptive to housing finance reform and regulatory reform during a time when further alignment is being sought.

Other lending products that will be negatively impacted as banks adjust to CECL include student loan programs, due to their unique repayment schedules and small business lending as a result of higher expected credit losses and reserve requirements. In order to offset the higher costs associated with lending to these customers, banks will be forced to offer more variable rate products in lieu of long-term fixed rate products, thus passing along more interest rate risk to consumers and posing more risk to the broader financial system.

Given these potential negative consequences from the implementation of CECL, Regions believes it is essential that an evaluation of the accounting standard's effect on the pricing, terms, and availability of credit and the overall impact on the economy and stability of the financial system be performed prior to the implementation of CECL. An evaluation is necessary to ensure these unintended consequences are avoided. Regions understands this evaluation will likely be a time intensive process that will require input and coordination among the FASB, the Agencies, and financial institutions. For this reason, we respectfully suggest the Agencies work with the FASB to delay CECL's implementation while studying the possible effects upon the economy and financial system and allow appropriate time to address any negative consequences prior to the implementation date, which is quickly approaching.

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[3] Reform Plan and Reorganization Recommendations: Delivering Government Solutions in the 21st Century, Office of Management and Budget (OMB), 75-77, *available at* https://www.whitehouse.gov/wp-content/uploads/2018/06/Government-Reform-and-Reorg-Plan.pdf.

Adjustments to CECL Methodology Should Be Considered to Avoid Unintended Adverse Consequences to Bank Lending Activities, the U.S. Economy, and Financial Statement Usefulness and Comparability

In addition to the potential negative impacts on bank lending activities and the broader economy outlined in the previous section, Regions believes the adoption of CECL will have negative implications to the decision-usefulness and comparability of financial statements for investors.

Application of a principles-based accounting standard like CECL will challenge interpretation and comparability among financial statement users. CECL is inconsistent with the historical accounting principle of matching revenues with expenses, does not reflect the true economics of lending transactions, and will pose significant challenges as users of financial statements attempt to extract decision-useful information for expected credit losses. Additionally, financial statement comparability among various financial institutions will be challenged as different assumptions, including reasonable and supportable forecast periods, will be developed by different financial institutions.

Given these constraints, Regions believes it is appropriate to consider adjustments to the CECL methodology that will address these concerns. One potential approach for enhancing income statement comparability would be to maintain a CECL compliant allowance for credit losses ("ACL") estimate on the balance sheet that is comprised of two components; an estimate of credit losses over the next twelve months and an estimate of expected credit losses over the remaining contractual term of an asset. The component for expected losses over the immediate twelve-month period would be reflected in the loss provision on the income statement and the component for expected losses over the remaining contractual term beyond the immediate twelve months would be reflected in other comprehensive income.

In addition to providing more beneficial financial statement information to better accommodate all the needs of financial statement users, financial institutions, and the Agencies, Regions believes this approach more appropriately reflects the economics of lending transactions and is necessary to mitigate concerns over CECL's negative impacts to bank lending activities and the broader economy. This proposed approach also is consistent with FASB's objectives to provide reporting on the amount that is expected to be collected over the life of an asset, as well as the ability to build loss reserves sooner than the current incurred loss model allows.

Adjustments to Regulatory Capital Are Necessary Once CECL Is Implemented

Regions welcomes the Agencies' acknowledgement that the implementation of CECL may reduce a banking organization's earnings or retained earnings and therefore its Common Equity Tier 1 capital ("CET1").[4] CECL's requirement to recognize expected losses over the contractual life of a loan will result in earlier recognition of credit losses and higher credit loss allowances that correspondingly reduce CET1 capital. As a result, banks will be required to increase their CET1 levels, despite the fact that there has been no change in the bank's underlying risk profile. This impact to earnings and capital will not occur solely on transition to CECL. Beyond initial adoption of CECL, updates of CECL estimates will lead to further volatility in earnings and capital.

[4] Proposal at 22314-15.

Regions respectfully request that the Agencies formally conclude whether or not their intent of CECL adoption is to increase bank capital requirements from current levels. We believe dramatic changes in quality and quantity of regulatory capital have occurred while the CECL accounting standard was being developed, primarily as a result of the Comprehensive Capital Analysis and Review (CCAR) process, such that there is not a need to increase bank capital requirements from current levels by further increases to loan loss reserves.

If, the Agencies agree that CECL implementation should not increase bank capital requirement from current levels, then Regions respectfully suggests that incremental reserves beyond those currently recognized under the incurred loss model be included in CET1 in order to maintain capital neutrality at current levels. The Tier 2 capital relief outlined in the Proposal is not sufficient due to the significantly higher cost of common equity capital; therefore, adjustment to CET1 requirements are necessary.

Appropriate capital relief from the incremental reserves that will be recognized under CECL can be achieved through various adjustments to regulatory capital requirements. The following options, listed in order of preference, would provide the necessary relief to avoid being overly punitive on bank capital levels.

- As detailed in the previous section, reflect expected losses for a one-year period in the provision for credit losses on the income statement, and reflect the remaining expected losses through other comprehensive income on the balance sheet.

- The Agencies could provide adjustments to CET1 for CECL reserves that exceed a defined horizon such as a one-year period.

- If incremental CECL reserves are not included in CET1, then CECL reserves beyond one year of expected losses should be deducted from risk weighted assets at a conversion factor of 1,250%.

- If none of the aforementioned adjustments are made to include incremental CECL reserves in regulatory capital, then adjustments to minimum regulatory capital requirements should be made in order to maintain neutral capital levels (i.e., capital levels should not increase by the difference between incurred losses and expected credit losses).

Integration of CECL into Supervisory Stress Testing and Its Interaction with the Stress Capital Buffer Proposal Should Be Further Considered to Avoid Dramatic Increases to Regulatory Capital Requirements and Placing Constraints on Economic Expansion

As stated previously, Regions believes, and many experts agree,[5] the conversion to CECL will likely increase volatility and capital, and the impact will be exacerbated by capital stress testing performed in accordance with the Dodd-Frank Act.

Under the current incurred loss approach, minimum post-stress capital levels for traditional regional banking organizations such as Regions are generally realized toward the end of the nine quarter

[5] *E.g.* Deniz Tudor and Timothy Daigle, Moody's Analytics, *White Paper: How Much Will CECL Impact Reserves for First Mortgages* (December 2017) at 1, 2 and 10; Wu, Deming, "The Current Expected Credit Losses (CECL) Accounting Standard: Practical Issues and Implications," Office of the Comptroller of the Currency, Nov. 2017.

planning horizon. Under the current regulatory capital stress testing regime, the adoption of CECL would accelerate the timing of credit losses without any corresponding acceleration in revenue recognition. This change will result in post-stress minimum capital ratios occurring earlier in the nine quarter stress test horizon. Also, given future revenue recognition is not realized in post-stress minimum ratios, CECL will result in lower capital ratios under theoretical stress tests that will drive higher capital requirements. This result will have significant impact upon the stress testing and capital planning processes that have been developed, particularly and most dramatically for regional banks.

Without changes to regulatory capital requirements as outlined in the previous section, the implementation of CECL will cause a direct increase in bank capital levels throughout the U.S. banking system as firms will need to retain additional capital in order to stay above regulatory minimum levels. Retaining additional capital will place significant constraints on increased lending and further economic expansion. Unless significant modifications are made to CECL, adjustments to regulatory capital requirements will be necessary to avoid these negative impacts to the U.S. banking system.

Further, the combination of CECL and the recently proposed stress capital buffer could result in banks having to hold significant excess capital, as buffer requirements for a baseline environment will be established under a theoretical stress scenario in which losses and post stress minimums are accelerated without any offsetting benefit from revenue generation. If capital neutrality from the impact of CECL is not achieved through the recommendations outlined in prior sections, the Agencies should make adjustments to the stress capital buffer requirements once CECL is fully implemented and should consider modifying the proposed stress capital buffer to be calibrated based on capital position at the end of the stress testing horizon rather than the minimum post stress level.

Regions respectfully recommends the Agencies continually reassess capital requirements and the stress capital buffer prior to CECL adoption, during the implementation phase, and post CECL adoption. Regions hopes the Agencies will remain flexible on this issue and work with the industry to avoid being overly punitive to bank capital levels.

Conclusion

Regions respectfully recommends the Agencies consider our concerns and proposed suggestions throughout this letter.

Regions greatly appreciates the opportunity to comment on this Proposal and to work with the Agencies on these and other important issues. Should you have any questions regarding these comments please do not hesitate to contact me directly.

Sincerely,

David J. Turner, Jr.
Chief Financial Officer
Regions Financial Corporation